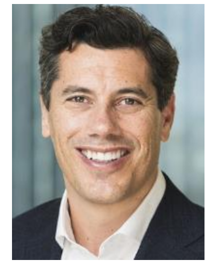
The Challenges Facing European M&A Despite Boom

By **Bruce Embley and Chetan Sheth**



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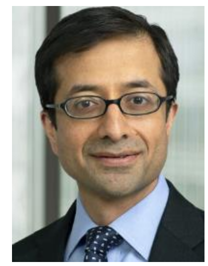

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Activity in European mergers and acquisitions has surged, ending fears that a dip during the initial months of the COVID-19 pandemic would be a precursor to a longer slump.

But while deal volume and values climbed steeply, powered in no small part by financial sponsors, challenges have emerged that have caused some transactions to fall through. And these challenges may give deal makers pause as they look ahead.

Investors and corporations are accustomed to assessing the probability of deals meeting conditions for antitrust and financial services approvals, but the increasingly interventionist approach of regulators, as well as the introduction of new foreign direct investment regimes in Europe, may alter the calculus.

Take, for example, Nvidia Corp.'s proposed purchase of U.K. semiconductor maker Arm Ltd., a high-profile transaction **that collapsed** after encountering regulatory challenges — in this case, from three jurisdictions:

- The U.K's Competition and Markets Authority, which had announced an in-depth review on both antitrust and national security grounds;
- The European Commission, which had said it would likewise conduct a detailed antitrust analysis; and
- The Federal Trade Commission, which sued to block the takeover, alleging the "combined firm would have the means and incentive to stifle innovative next-generation technologies."

Despite the parties' attempts to resolve these regulatory concerns, the deal was ultimately called off, more than 16 months after it was announced.

Also take, for example, the U.K. Competition and Markets Authority order, **currently under appeal**, for what is now Facebook parent Meta Platforms Inc. to sell clip platform Giphy. The order, issued after the purchase was complete, may also signal a shift in regulators' attitude toward acquisitions of startup technology companies by large ones.

Transactions may no longer be exempt from regulatory review simply because they do not present traditional antitrust concerns, such as significant market overlap. This may be especially true where startups are acquired before growing enough to establish themselves as competitors in the market

In this case, the CMA found that Giphy was considering expanding its advertising services to countries outside the U.S., and the acquisition could potentially remove a competitor to Facebook's own display advertising services in the U.K. [1]

Newly adopted national security review processes in many countries could also pose additional obstacles.[2] In the competitive landscape seen over the last 18 months or so, public company boards have taken a hard-nosed approach, successfully playing bidders off against each other, and forcing them to pay higher multiples for the most sought-after assets. However, in some cases, the high bidder nonetheless failed to secure the target.

Take, for example, Advent International Ltd. and Aurora Investment Pte. Ltd., an affiliate of sovereign wealth fund GIC Private Ltd. The two companies **came very close to prevailing** with their $8 billion proposed buyout of Swedish biotech company Sobi.

Approximately 83.7% of shares were tendered to an offer representing a 35% premium. But the bidders needed 90% acceptance to allow a compulsory purchase of the remaining shares, known as the squeeze-out, and they walked away.

Before recommending a bid, boards have also been required to weigh the increased public scrutiny of deals and — particularly where private equity bidders are involved — stakeholders' concerns about securing a longer-term future for the business.

In the U.K., for example, the **proposed takeover** of mutually owned life insurer Liverpool Victoria by Bain Capital Credit prompted significant pushback from both pro-mutual LV members and politicians, who questioned the rationale for the deal and the choice of Bain.

In a statement in 2021, LV's management said in a statement that Bain's offer was the only option that would acheive "an excellent financial outcome" for members and support for investment and employees. But critics attacked the plan to demutualize LV.

They deemed the offer to members insufficient, questioned the benefits that would be received by management and argued that the deal would allow Bain to extract assets that had been accumulated over years as a mutual insurer. Ultimately, only 69% of LV's members who voted at the meeting convened to approve the deal supported it, below the 75% threshold required for the sale to proceed.

Given the pressure that had been exerted by opponents during the Bain process as to why an offer from fellow mutual Royal London was not pursued, it is unsurprising that following the collapse of the Bain transaction, LV did subsequently engage with Royal London, albeit the parties subsequently announced that those discussions had also ceased.

These cases notwithstanding, new opportunities have also emerged, in part due to the disruption caused by the pandemic. Corporate boards sought to make their companies more efficient and refocused their strategic priorities, in some cases, pushed by activist shareholders. This led to an increase in carveout transactions.

In a trend that is likely to continue this year, private equity featured prominently in auctions for these assets, including:

- Unilever PLC's sale of its global tea business to CVC Capital Partners; and
- Lonza AG's sale of its Lonza Specialty Ingredients specialty chemicals division to Bain Capital and Cinven Group.

The pandemic intensified the focus on environmental, social and governance considerations, with the U.N. Climate Change Conference contributing to this in Europe. The preferences of limited partners, consumers and employees for ESG-positive companies became an increasingly significant factor in M&A, as it was reported that some sellers saw bidders pull out of potential acquisitions due to ESG concerns.

That may lead other sellers to reconsider bringing assets to the market if they have not addressed these ESG issues.

Conclusion

Europe's current wave of M&A shows no signs of abating. But although deal flow continues to be strong, stricter antitrust and national security reviews may pose obstacles for some mergers.

Financial sponsors remain very active, and with more corporate divestitures appearing likely, are expected to remain prominent players. Increased public scrutiny and shareholder resistance could prove to be stumbling blocks and measures taken to tame inflation could cool the appetite of some buyers.

However, sellers will no doubt seek to take advantage of frothy valuations before the market turns. Meanwhile, investors will eye the prospect of higher financing costs if inflation fears lead central banks to adopt more hawkish stances on interest rates. Thus, there are incentives for both buyers and sellers to make hay while the sun shines.

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[1] https://www.skadden.com/insights/publications/2022/01/2022-insights/regulation-enforcement-and-investigations/deal-uncertainty-increases.

[2] https://www.skadden.com/insights/publications/2022/01/2022-insights/regulation-enforcement-and-investigations/cfius-goes-global.